EUROPE and CENTRAL ASIA

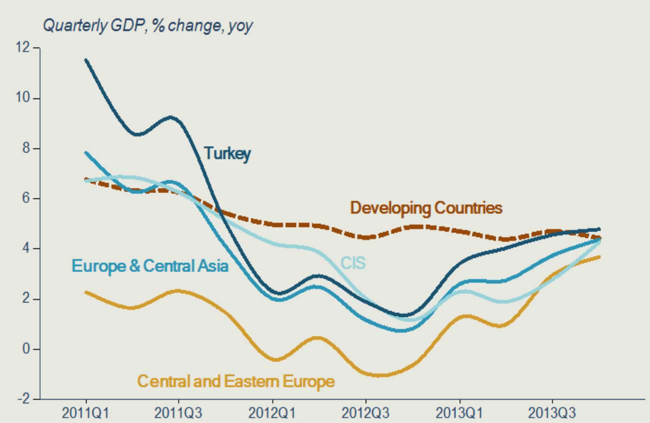
GLOBAL ECONOMIC PROSPECTS | June 2014 | Chapter 2

A diverging recovery is underway in the developing Europe and Central Asia region. The recovery in the Euro Area is boosting exports in Central and Eastern Europe. For the countries further east, which are highly exposed to weakening activity in Russia and declining commodity prices, near-term prospects have weakened. An escalation of political tensions between the EU and Russia is a key downside risk to the regional forecasts.

Recent developments

A modest, external demand-driven recovery is underway in developing Europe and Central Asia.[1] Growth in developing Europe and Central Asia picked up in 2013, averaging 3.6 percent, up from 1.9 percent in 2012 (table 2.4 and figure 2.7). Robust activity in core Euro Area countries and a winding down of earlier fiscal consolidation lifted growth in the developing Central and Eastern Europe sub-region[2] to 2.2 percent in 2013 from -0.3 percent in 2012. Good agricultural harvests provided additional momentum in Hungary, Moldova, Romania, and Serbia. In most countries in the sub-region, the pickup in growth narrowed substantially negative output gaps. Growth in the developing Commonwealth of Independent States[3] increased to 4.0 percent in 2013 from 3.4 percent in 2012, as solid energy prices supported growth in energy exporters and fiscal policy loosened in several countries. For the broader geographical region including recently-high-income countries,[4] average growth slowed to 2.2 percent in 2013 (from 2.3 percent in 2012) as the recovery in most countries suffered a setback from sluggish growth in domestic demand.

Figure 2.7 Growth in the developing Europe and Central Asia region continues to strengthen



Source: Datastream, World Bank.

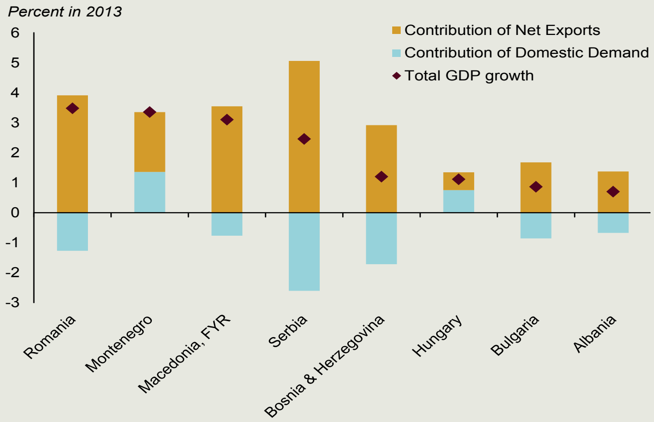
1. Countries in developing Europe and Central Asia region include only the low- and middle-income countries of the geographic region. See also footnote 2 and 3.

2. Countries in the developing Central and Eastern Europe sub-region are Albania, Bosnia and Herzegovina, Bulgaria, Georgia, Hungary, Kosovo, Macedonia FYR, Montenegro, Romania, and Serbia.

3. Countries in the developing Commonwealth of Independent States sub-region are Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyz Republic, Moldova, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan.

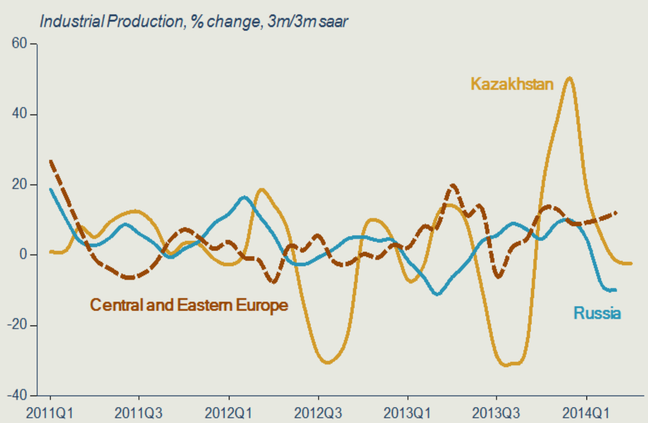
4. These include Croatia, the Czech Republic, Estonia, Latvia, Lithuania, Poland, Russian Federation, Slovenia, and Slovak Republic.

Figure 2.8 **Growth in developing Central and Eastern Europe has been export-driven**



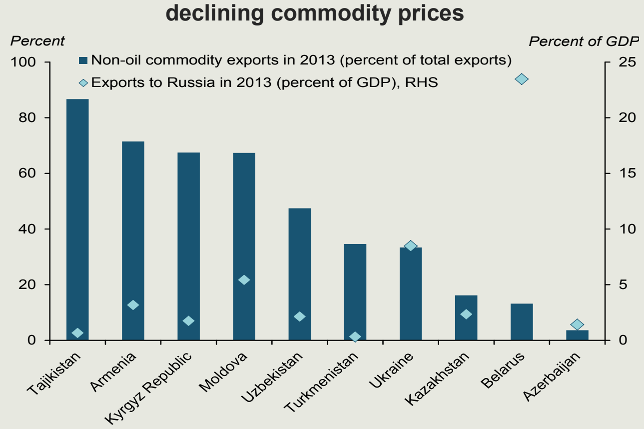
Source: Datastream, World Bank.

Figure 2.9 **Industrial production is slowing in the developing Commonwealth of Independent States**



Source: Datastream, World Bank.

Figure 2.10 **Developing Commonwealth of Independent States are exposed to slowing Russia and declining commodity prices**



Source: COMTRADE, IMF Direction of Trade.

In developing Central and Eastern Europe, growth is increasingly driven by the recovery in advanced Europe. In early 2014, industrial production and business sentiment generally pointed to strengthening activity across Central and Eastern Europe, as the recovery in Central Europe began to feed through the supply chain in Eastern Europe (figure 2.8). On average, rising import demand from advanced Europe contributed to export growth of 11.5 percent in March on a year-on-year basis, led by Hungary, Romania, and Turkey. Notwithstanding market concerns and significant monetary policy tightening in early 2014, Turkey's industrial output continued to expand in the first three months of the year, helped by strong export growth. But momentum has slowed, and slides in business and consumer confidence suggest softening of domestic demand ahead.

In contrast, among the developing Commonwealth of Independent States, trading partner slowdowns, geopolitical tensions, declining metal and mineral prices, and domestic capacity constraints have slowed growth in 2014. Monthly industrial production data for Kazakhstan, Ukraine, and Russia indicates sharp slowdowns in early 2014 (figure 2.9). Notwithstanding fiscal expansion and continued monetary accommodation, growth in Kazakhstan moderated as activity slowed in the country's main trading partners—Russia and China—and reflecting further delays in bringing additional oil production capacity onstream. In Ukraine, escalating tensions with Russia and domestic political instability contributed to a 12.5 percent (q/q saar) contraction in Q1 GDP (see Box 2.1). Elsewhere in the sub-region, terms of trade deteriorated substantially. In particular, prices of industrial metals and minerals declined by 4.4 percent since end-2013 and those of raw materials by 5.5 percent (energy prices were down by 0.5 percent). The net impact of terms of trade deteriorations are estimated to potentially reduce GDP in 2014 by 2.2 to 2.5 percent in Tajikistan and Kyrgyz Republic, and by 0.2 to 0.5 percent in Armenia and Kazakhstan (figure 2.10).

The generally accommodative monetary policy stance of 2013, with policy rates at historical lows in many countries, persisted through 2014 in most countries. Cuts in policy rates or the bottoming out of deflation have begun to reduce real policy rates in several countries. Exceptions were Georgia, Ukraine, and initially Turkey, where monetary policy tightened in early 2014 against the backdrop of rising credit growth, inflation and depreciation pressures. Turkey unexpectedly cut its benchmark interest rate in May by 50 basis points despite rising inflation (see below), based on the expectation that inflation should decelerate later this year because of slowing domestic demand.

The fiscal policy stance eased in many countries in the region. In developing Central and Eastern Europe, earlier fiscal tightening ended or was partially reversed in 2013. Modest fiscal consolidation continued in Bosnia and Herzegovina, Macedonia FYR, and Serbia where sizeable fiscal deficits have yet to be unwound. In the developing Commonwealth of Independent States, fiscal deficits generally increased despite robust real GDP growth (Azerbaijan, Tajikistan, Uzbekistan). In contrast, Georgia succeeded in containing the fiscal deterioration in 2013 despite a sharp growth slowdown.

Several countries have come under market pressure as a result of increasing investor concerns about high external debt and political tensions. The Turkish lira depreciated nearly 8 percent against the dollar in January, but an aggressive tightening of monetary policy in the same month has helped stabilize the currency. The Hungarian forint depreciated by 7 percent also in January amid continuing investor concerns about economic policies that discourage FDI compounded by pressures on emerging market currencies more broadly. The Ukrainian hryvnia depreciated by 40 percent during the first four months of 2014 as large current account deficits and high external debt amid escalating domestic political and geopolitical tensions undermined investor confidence. In part to avert a loss of competitiveness against their main trading partner's currency, both Kazakhstan—which is a member of the Eurasian Customs Union with Russia and Belarus—and Kyrgyzstan allowed double-digit devaluation and depreciations in February 2014.

Inflation has picked up in countries with substantial depreciations or domestic demand pressures, but remained well below target in countries with significant slack in labor markets. Masking diverging inflation trends within the region, average inflation in the region rose to 10.2 percent in the first four months of 2014 from 5.7 percent in a year earlier; however, this was driven by persistent high inflation in several large countries. In Turkey, in particular, inflation has risen sharply and reached 9.4 percent in April. Further rises are likely following the central bank's decision in late May to cut its main policy rate by 50 basis points. In Belarus, Kyrgyz Republic, Uzbekistan and Ukraine, inflation also remained high driven by fiscal pressures and high credit and real-wage growth (Belarus, Uzbekistan) and the pass-through of recent depreciations (Kyrgyz Republic, Ukraine). The opposite was the case in much of high-income and developing Central and Eastern Europe where negative output gaps and labor market slack helped keep inflation well below target levels or even negative on a year-on-year basis. Slowing food price inflation helped dampen inflation in a number of smaller economies in the developing Commonwealth of Independent States (e.g., Armenia and Tajikistan).

Capital flows in developing Europe and Central Asia declined especially among the larger countries in the region. Gross capital flows to developing Europe and Central Asia fell by 42 percent to $26 billion during the first five months of 2014 compared to the same period a year earlier. Although several countries succeeded in placing modest-sized bond issues in the first five months of 2014, issuance was down sharply, especially in Kazakhstan, Turkey, and Ukraine. Equity issuance dried up entirely in early 2014, as the weakness of 2013 persisted. Syndicated bank lending halved to $8 billion, with the drop in banking flows to Turkey (and, to a lesser extent, Kazakhstan) accounting for the bulk of the reduction. Anecdotal evidence suggests that outflows from Russia (estimated at $64 billion during the first quarter) may be diverted into other developing economies, in particular Turkey.

Remittance inflows from Russia were resilient and helped finance current accounts and domestic activities in a number of countries in developing Commonwealth of Independent States. A resilient labor market despite the growth slowdown in Russia helped generate an increase in aggregate remittance flows from Russia to the sub-region by 16.8 percent in Q4 2013 year-on-year. Average year-on-year growth rates of 20-25 percent were maintained in most recipient countries (Armenia, Azerbaijan, Kazakhstan, Kyrgyz Republic, and Turkmenistan)—except in Ukraine where remittances from Russia dropped from the equivalent of US$900mn in the previous year to near-zero in Q3 2013.

Outlook

After expanding by an estimated 3.6 percent in 2013, GDP growth for the region is projected to temporarily weaken in 2014 owing to a sharp slowdown in a number of large economies in the region, including Turkey, Kazakhstan, and the Ukraine. Growth in 2014 is expected to average 2.4 percent before picking up again to 3.7 and 4.0 percent in 2015-16. The slowdown in 2014 will be more marked in developing Commonwealth of Independent States, driven by weaker growth of the two largest economies (Kazakhstan and Ukraine) as a result of slowdowns in Russia and China—the sub-region's important trading and investment partners—and a weakening trend in key commodity prices.

Developing countries in Central and Eastern Europe are expected to see recoveries in growth in 2014 as they continue to benefit from strengthening import demand from the Euro Area.

Table 2.4 **Europe and Central Asia forecast summary**
(annual percent change unless indicated otherwise)

	00-09[a]	2010	2011	2012	2013e	2014f	2015f	2016f
GDP at market prices[b]	4.0	5.9	6.2	1.9	3.6	2.4	3.7	4.0
	(Sub-region totals-- countries with full NIA + BOP data) [c]							
GDP at market prices[c]	4.0	6.0	6.3	1.9	3.6	2.3	3.6	3.9
GDP per capita (units in US$)	3.6	5.2	5.5	1.2	2.8	1.6	3.0	3.3
PPP GDP	4.3	5.8	6.0	2.0	3.5	2.2	3.7	3.9
Private consumption	4.7	4.4	7.0	1.4	4.8	1.9	3.5	4.1
Public consumption	3.0	0.4	2.9	4.3	2.9	4.3	4.7	3.7
Fixed investment	5.0	11.1	10.3	-0.7	3.2	-0.2	7.3	7.9
Exports, GNFS[d]	5.0	8.3	8.7	4.0	2.2	4.2	5.5	5.3
Imports, GNFS[d]	5.3	12.5	11.3	1.5	4.9	2.5	6.1	6.8
Net exports, contribution to growth	-0.1	-1.5	-1.1	0.9	-1.1	0.6	-0.4	-0.8
Current account bal/GDP (%)	-3.7	-3.2	-4.2	-3.7	-4.3	-3.3	-3.8	-3.9
GDP deflator (median, LCU)	9.4	8.5	8.6	3.4	2.8	5.0	5.5	4.5
Fiscal balance/GDP (%)	-4.5	-2.6	0.4	-0.5	-1.3	-1.4	-1.6	-1.5
Memo items: GDP								
Broader geographic region (incl. recently high income countries)e	4.0	4.7	4.9	2.3	2.2	1.7	2.7	3.2
Central and Eastern Europe[f]	3.4	0.3	2.0	-0.3	2.2	2.5	2.9	2.8
Commonwealth of Independent States[g]	6.6	6.1	6.0	3.4	4.0	2.2	4.6	4.9
Kazakhstan	7.5	7.3	7.5	5.0	6.0	5.1	5.9	6.0
Turkey	3.0	9.2	8.8	2.1	4.0	2.4	3.5	3.9
Romania	4.4	-0.9	2.3	0.4	3.5	2.8	3.2	2.9

Source: World Bank.
a. Growth rates over intervals are compound weighted averages; average growth contributions, ratios and deflators are calculated as simple averages of the annual weighted averages for the region.
b. GDP at market prices and expenditure components are measured in constant 2010 U.S. dollars.
c. Sub-region aggregate excludes Bosnia and Herzegovina, Kosovo, Montenegro, Serbia, Tajikistan and Turkmenistan. Data limitations prevent the forecasting of GDP components or Balance of Payments details for these countries.
d. Exports and imports of goods and non-factor services (GNFS).
e. Recently high-income countries include Croatia, Czech Republic, Estonia, Latvia, Lithuania, Poland, Russian Federation, and Slovak Republic.
f. Central and Eastern Europe: Albania, Bosnia and Herzegovina, Bulgaria, Georgia, Kosovo, Lithuania, Macedonia, FYR, Montenegro, Romania, Serbia.
g. Commonwealth of Independent States: Armenia, Azerbaijan, Belarus, Kazakhstan, Kyrgyz Republic, Moldova, Tajikistan, Turkmenistan, Ukraine, Uzbekistan.

GDP growth in the sub-region is expected to reach 2.5 percent in 2014 and 2.8-2.9 percent in 2015-16, up from -0.3 percent in 2013. External demand will remain the key driver of growth in Bulgaria, Bosnia and Herzegovina, Macedonia FYR, and Serbia where consumer and business confidence remain low over lingering political uncertainty, chronically high unemployment, and still fragile banking systems saddled with high nonperforming loans (NPLs). Confidence and domestic demand are further curtailed by severe weather affecting a large area of Southeastern Europe, especially Serbia and Bosnia and Herzegovina, causing floods and landslides, dislocating several thousand people, and inundating mines, agricultural lands, energy and production facilities.

In Hungary and Romania, in contrast, there are clearer signs that stronger external demand is spilling over into improvements in the labor market and recoveries in domestic demand. In general across the region, low inflation will allow central banks to maintain accommodative policies to support the recoveries in domestic demand.

In Turkey, the growth outlook has deteriorated in light of tighter global financial conditions and reduced emerging market capital flows. Whereas recent activity indicators have pointed to surprise resilience in the economy mainly thanks to buoyant export demand, consumer confidence and domestic demand are slowing with higher inflation and the depreciated lira

Table 2.5 **Net capital flows to Europe and Central Asia ($billions)**

	2008	2009	2010	2011	2012	2013e	2014f	2015f	2016f
Capital Inflows	277.3	60.2	95.4	125.6	118.1	118.3	132.1	151.5	158.5
Foreign direct investment	164.0	45.7	18.3	69.4	60.4	41.3	39.2	44.3	49.5
Portfolio investment	-6.9	-0.4	44.0	33.5	51.4	47.8	44.5	43.7	41.8
Equity	-0.4	3.7	3.7	-0.7	8.1	2.1	4.3	5.2	6.4
Debt instruments	-6.5	-4.0	40.3	34.1	43.4	45.7	40.2	38.5	35.4
Other investment /a	120.3	14.8	33.1	22.7	6.3	29.2	48.4	63.5	67.2
o/w									
Bank lending	132.3	14.2	-18.9	33.0	8.0	16.0	15.3	19.7	22.7
Short-term debt flows	5.7	-9.9	41.6	14.1	9.0	13.1	19.5	24.5	30.4
Official inflows	24.6	49	28	6.9	-6.9	5.1	13.0	15.0	10.0
World Bank	1.2	3.4	3.9	2.9	2	3.1	..	..	..
IMF	12.8	25.5	9	-1	-13	-4	..	..	..
Other official	10.6	20.2	15.1	5.1	4	6	..	..	..
Memo items (as a percentage of GDP)									
Current account balance	-5.2	-2.4	-3.6	-4.6	-4.0	-4.8	-3.6	-4.1	-4.2
Capital inflows	18.5	4.9	6.7	7.9	7.3	6.9	8.0	8.4	8.0
Capital outflows	9.9	1.4	1.4	2.6	3.2	1.8	..	..	..
Memo items: capital inflows including recently transitioned to high income economies ($ billions) /b									
Capital Inflows	459.6	122.1	218.2	246.8	249.9	279.6	255.1	265.1	284.4
Foreign direct investment	275.5	106.4	91.0	152.5	131.8	125.1	120.4	127.3	138.5
Portfolio investment	-38.2	33.7	88.2	49.1	108.2	63.8	69.6	69.5	73.4
Equity	-16.7	8.8	6.8	-7.4	12.6	-2.8	11.1	9.3	10.2
Debt instruments	-21.5	24.9	81.4	56.5	95.5	66.6	58.5	60.2	63.2
Other investment /a	222.4	-18.1	39.0	45.3	10.0	90.7	65.1	68.3	72.5

Source: World Bank.
/a including short-term and long-term private loans, official loans, other equity and debt instruments, and financial derivatives and employee stock options.
/b including Croatia, Czech Republic, Estonia, Latvia, Lithuania, Poland, Russia Federation, and Slovak Republic
Note: e = estimate, f = forecast.

constraining private consumption and investment. Slower domestic demand, however, should help narrow current account deficit to 6.0 percent of GDP.

Growth in the developing Commonwealth of independent States sub-region is projected to slow in the near-term. Growth for 2014 is forecast at 2.2 percent, down from an estimated 4.0 percent in 2013, before rising again to an average 4.6 and 4.9 percent in 2015-16. The slowdown in the near-term is led by weaker growth of the two largest economies in the sub-region, Kazakhstan and Ukraine and spillovers from a slowdown in Russia (see Box 2.1).

Growth in resource-rich countries in the sub-region (Azerbaijan, Kazakhstan, Uzbekistan) will continue to be above the regional average, supported by still relatively high oil and gas prices, robust government investments, and generous social transfers. While oil prices are expected to remain high at $103 a barrel on average in 2014 (1 percent below the 2013 average), oil output in Azerbaijan and Kazakhstan is expected to stagnate as capacity expansion is delayed until 2015-16. Non-oil sector growth is also set to decelerate in both countries because of tighter fiscal policy (Azerbaijan) and slower credit growth (Kazakhstan). In Uzbekistan, buoyant natural gas exports will continue to drive strong growth, but with its two other key export commodities (cotton and gold) well below 2010-13 levels and its major export markets (including Russia, Turkey, Ukraine, and China) set to decelerate, projected growth is lower than what it has seen in the past decade (averaging 8 percent).

Among the non-energy exporting Commonwealth of Independent States, growth is expected to remain sluggish with significant downside risk from a slowdown in Russia and a deeper recession in Ukraine. Belarus is particularly exposed, as it trades heavily with both Ukraine (8.8 percent of its total trade) and Russia (47.5 percent). Armenia, Tajikistan, Kyrgyz

Republic, and Moldova are vulnerable to dislocations in the Russian labor market because remittances from Russia account for a large part of GDP (see also Box 2.1). While the currently available forecast does not project material weakening in remittances—remittances to the Commonwealth of Independent States are projected to increase by 8.3 percent in 2014—there are substantial downside risks.

Risks

Heightened tensions between the EU and Russia are a key downside risk to the regional forecasts. Tensions between Russia and Ukraine have so far resulted in limited sanctions by the US and the EU, such as interruption of trade negotiations, non-participation in G8, freezing of assets and visa bans on a limited number of former Ukrainian and Russian officials. Commodity markets and financial markets (outside these two countries) have thus far shown little response. However, should tensions further escalate, more intrusive sanctions, possibly interrupting trade and banking flows, cannot be ruled out. Given the close economic interdependence between the EU and Russia (see Box 2.1), the escalation of sanctions would likely impose large economic costs, damaging recoveries in both. For instance, in Russia, oil revenues represent 9 percent of GDP and 25 percent of government revenues, and a loss of EU export markets could reduce government revenues by 10 or more percent of GDP. In Central and Southeastern Europe (e.g., Germany, Italy, Hungary, and Poland), especially, Russia accounts for up to 80 percent of gas imports. If the current consumption of Russian natural gas was to be replaced by global imports (assuming a ready supply could be found without raising global prices), the EU's costs of natural gas import could rise temporarily by 50 percent (or about 0.15 percent of GDP). More dependent countries would see higher increases in gas cost. For example, costs in Hungary and Poland could rise by 1.4 and 0.4 percent of GDP, respectively. Such large costs on both the EU and Russia could significantly derail the economic recoveries in both, with ramifications for the entire region.

Disorderly adjustments to higher global interest rates—due to anticipated or actual monetary policy tightening or increases in risk aversion—continue to be a risk. The initial reaction to the start of tapering in early January was calm, but subsequent bouts of market volatility reflect greater investor sensitivity to global monetary and risk conditions. There remains a risk that market reaction to the further withdrawal of extraordinary monetary measures in the US could be less orderly than is currently anticipated.

Despite broadly encouraging recent data, downside risks to a sustained recovery in the developing Central and Eastern Europe sub-region remain substantial. Especially in Southern Europe (Albania, Bulgaria, Bosnia and Herzegovina, Macedonia FYR, Montenegro, Serbia), there are clear downside risks to domestic demand growth, relating in the near term to devastating floods (notably in Serbia and Bosnia and Herzegovina), and in the medium term to still high unemployment, high private sector debt, and the slow recovery in bank lending amid high and in some cases rising NPLs. Even though the high levels of NPLs have not caused serious instability of the financial sector so far, as these loans appear to be well-provisioned and backed by adequate bank capital, not tackling this risk head-on may further destabilize the fragile banking sector and threaten credit recovery and growth prospects. At the same time, lack of progress in fiscal consolidation and insufficient effort in tackling remaining structural problems (e.g., large public sector wage bill, expensive and poorly-targeted social transfers, restructuring of the state-owned enterprises) leave little fiscal room for bold policy action to counter lingering deflation threats and to increase growth-promoting investments.

Downside risks to commodity prices and potential weakening of remittance inflows from Russia represent a major source of uncertainty for countries among developing Commonwealth of Independent States. Most countries in the sub-region are heavily exposed to one or a few commodity exports—including Azerbaijan, Armenia, Kazakhstan, Tajikistan, and Uzbekistan (figure 2.10)—which increase their susceptibility to volatile commodity prices. In addition, Russia is the most important export market for majority of the sub-region as well as the most important source of inward remittances and FDIs. What's more, the Commonwealth of Independent States are heavily integrated with each other—other Commonwealth of Independent States are their major trading partners as well as sources of labor remittances (figure B2.1.2)—implying that there is a significant potential for a negative feedback loop whereby a downturn in the region becomes self-reinforcing.

Box 2.1 Ukraine crisis and impact on the ECA region

Recent developments

The tensions with Russia have heightened at a time when Ukraine's economy was already showing strains from mounting external and internal imbalances. Growth was anemic in 2013, with consolidated fiscal deficit and current account deficit reaching 7 and 9 percent of GDP, respectively, and short-term external debt exceeding $35bn (more than 30 percent of total external debt). Sharp depreciation of hryvnia in early month of 2014 created further pressure on foreign reserves, sovereign default risks, and liquidity crisis in the already struggling banking sector (with non-performing loans exceeding 38 percent in 2013). An emergency financing from the international community, including $17.1bn (of which $3.2bn available immediately) from the IMF and $1.5bn from the World Bank, will help Ukraine avert economic and financial collapse but its success will be contingent on the new government undertaking significant stabilization and structural reforms, including adjustment of energy prices and social outlays.

Outlook

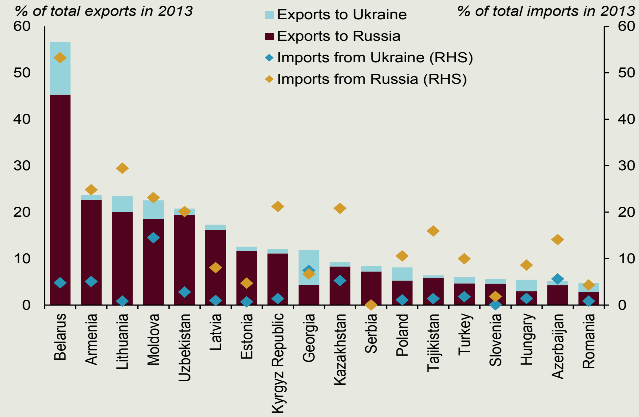
Ukraine's GDP is expected to shrink by 5.0 percent in 2014, taking into account several key developments that have worsened the outlook since January, including the loss of access to its biggest export market (Russia), sharp rises in the price of imported gas, and declines in commodity prices for steel and wheat—two of the country's key exports. Currency depreciation, shocks to Russian gas imports, and removal of domestic fuel subsidies will accelerate inflation, eroding household incomes and depressing consumption. The weak banking sector will also constrain credit growth and investment even if an outright banking crisis was avoided. While the country's exports could theoretically benefit from a weaker hryvnia, given the disruption of present trade linkages—as much as a third of Ukraine's total exports had gone to Russia and the members of the Eurasian Customs Union countries in 2013 (mainly consisting of heavy machinery, iron and steel, and nuclear reactors)—redirection of the country's exports to the West may not be easy over the short term. We therefore forecast only a slow and gradual recovery in 2015-16 (2.5 and 4.0 percent, respectively).

Impact on Europe and Central Asia

As the fifth largest country in developing Europe with close trade and financial links with the rest of the region, a deeper recession in Ukraine will have a negative impact on neighboring countries via trade and financial links. However, the impact on the region will depend on Russia as it is the largest export market and the major source of remittances for many countries especially in Central Asia, as well as the major supplier of oil and gas to both developing and developed Europe.

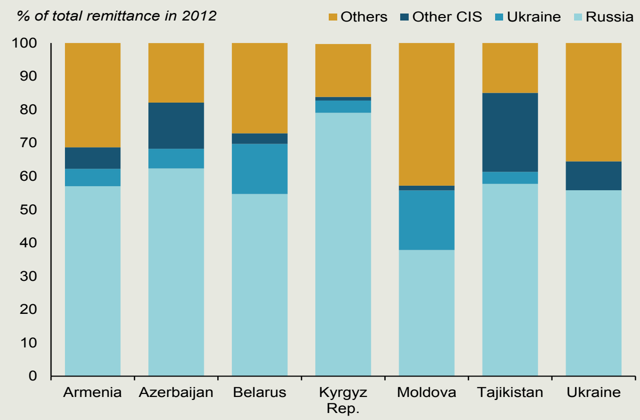
a. Trade link—Several countries are heavily exposed to both Russia and Ukraine via trade links (figure B2.1.1). Belarus, Georgia, Moldova have the tightest trade links with Ukraine (both export and import). Belarus is the most exposed, as it trades heavily with both Ukraine (7.8 percent of its total trade) and Russia (49.5 percent). Georgia has close trade links with Ukraine (7.5 percent of total trade) but relatively small exposures to Russia (5.1 percent), having increased its trade with Europe. Moldova, Armenia, and Kazakhstan rely on Ukraine mostly for their imports but all of them are heavily exposed to Russia for their exports (20, 19, and 12 percent of total exports, respectively). Baltic countries also have significant Russian exposures of between 10-20 percent of total exports. In contrast, developing Central and Eastern European economies only send between 0-8 percent of total exports to both Russia and Ukraine.

Figure B2.1.1 Several countries are heavily exposed to Russia and Ukraine via trade links



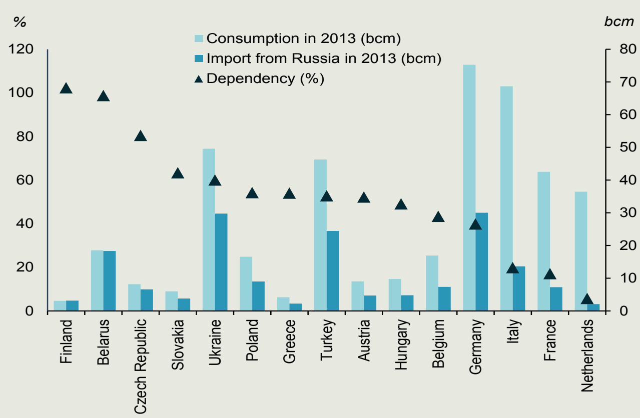
Source: IMF Direction of Trade.

Figure B2.1.2 Russia and Ukraine are important sources of remittances in the Commonwealth of Independent States



Source: World Bank Bilateral Remittance Matrix 2012.

Figure B2.1.3 Dependency on imported gas from Russia varies across countries in the region



Source: BP Statistical Review of World Energy and BMI.

b. Financial link—Compared to US banks, EU banks are relatively heavily exposed to Russia, and in particular Russian corporates, and to a lesser extent to Ukraine. Total EU bank exposure to Ukraine is estimated to be around US$ 23bn (around 0.1 percent of the total exposure of reporting banks on ultimate risk basis). Austrian and Italian banks are the most exposed to Ukraine. EU bank exposure to Russia is $165bn (about 1.0 percent), with France, Italy, and German banks among the most exposed. The US bank exposure to Russia is estimated to be $32bn (about 1.1 percent). Data for Russian banks' exposure to Ukraine is not readily available but four Russian banks (Gazprombank, Sberbanks, the majority-state-owned VTB, and the state development bank VEB) are reported to hold between them an estimated $28bn of *assets* in Ukraine.

c. Remittance link—Based on the World Bank's estimates of bilateral remittance matrix in 2012, remittances from Ukraine represent sizeable share of total in Moldova (18 percent) and Belarus (15 percent), while those from Russia represent major shares among most developing Commonwealth of Independent States, (40-79 percent) and particularly high in Kyrgyz Republic (79 percent) (figure B2.1.2). Given the high share of remittances to GDP in general, Tajikistan (52 percent), Kyrgyz Republic (31 percent), Moldova (25 percent) are among the most vulnerable to transmission of shocks through this link. While the resilience of remittance flows from Russia so far despite its growth deceleration is reassuring, deeper recession in Russia (and Ukraine) could slow and reverse the significant rising trends in remittance inflows which, given their importance, would have a major impact on these countries' current account balance, household consumption, and poverty dynamics.

d. Energy link—Russia supplies 30 percent of the natural gas consumed in Europe. Dependency on imported gas from Russia varies across the member states (figure B2.1.3) from a low of 20 percent in Italy to a high of over 100 percent in Latvia, although the dependency ratio tends to be higher among smaller consumers of natural gas. In 2012, Poland depended on Russia for nearly 50 percent of its natural gas consumption, and Lithuania, over 90 percent. Since Russia's economy relies heavily on revenue from gas exports to Europe (9 percent of GDP, a quarter of government revenues, and nearly two-thirds of export revenues), the mutual dependency in energy markets, we believe, will likely contain the chance of sharp escalation of tensions between the EU and Russia although it cannot be ruled out.

Table 2.6 Europe and Central Asia country forecasts

	00-09[a]	2010	2011	2012	2013e	2014f	2015f	2016f
Albania								
GDP at market prices (% annual growth)[b]	4.9	3.8	3.1	1.3	0.4	2.1	3.3	3.5
Current account bal/GDP (%)	-8.5	-10.1	-13.3	-10.3	-10.6	-10.3	-12.4	-14.8
Armenia								
GDP at market prices (% annual growth)[b]	7.7	2.2	4.7	7.2	3.5	5.0	5.0	5.0
Current account bal/GDP (%)	-8.8	-14.2	-11.4	-12.0	-10.5	-8.7	-7.7	-7.0
Azerbaijan								
GDP at market prices (% annual growth)[b]	14.4	4.9	0.1	2.2	5.8	5.2	4.1	3.6
Current account bal/GDP (%)	3.2	28.4	26.0	22.5	16.5	12.6	8.1	5.6
Belarus								
GDP at market prices (% annual growth)[b]	6.6	7.7	5.5	1.7	0.9	-0.5	1.5	1.0
Current account bal/GDP (%)	-4.3	-15.0	-7.9	-2.9	-10.2	-8.4	-9.8	-7.6
Bosnia and Herzegovina								
GDP at market prices (% annual growth)[b]	4.0	0.7	1.3	-1.1	1.8	2.0	3.5	3.5
Current account bal/GDP (%)	-13.3	-5.6	-8.8	-9.6	-7.5	-6.6	-6.3	-6.1
Bulgaria								
GDP at market prices (% annual growth)[b]	4.0	0.4	1.8	0.6	0.9	1.7	2.4	2.8
Current account bal/GDP (%)	-11.3	-1.5	0.1	-0.8	1.9	-0.5	-1.4	-1.6
Georgia								
GDP at market prices (% annual growth)[b]	5.6	6.3	7.2	6.2	3.2	5.0	5.5	6.0
Current account bal/GDP (%)	-11.2	-10.3	-12.5	-11.9	-5.9	-8.1	-7.8	-7.6
Hungary								
GDP at market prices (% annual growth)[b]	1.8	1.3	1.6	-1.7	1.1	2.4	2.5	2.5
Current account bal/GDP (%)	-6.8	0.2	0.4	0.4	2.8	2.5	2.0	1.8
Kazakhstan								
GDP at market prices (% annual growth)[b]	7.5	7.3	7.5	5.0	6.0	5.1	5.9	6.0
Current account bal/GDP (%)	-2.0	1.0	5.4	-0.4	-0.1	1.0	1.5	1.6
Kosovo								
GDP at market prices (% annual growth)[b]	5.8	3.9	4.5	2.7	3.0	3.5	3.5	4.0
Current account bal/GDP (%)	-7.3	-12.0	-13.8	-7.6	-6.5	-7.4	-7.2	-7.3
Kyrgyz Republic								
GDP at market prices (% annual growth)[b]	4.2	-0.5	6.0	-0.1	10.5	6.5	5.4	5.3
Current account bal/GDP (%)	-5.1	-6.4	-6.0	-15.0	-13.5	-15.7	-14.5	-12.6
Moldova								
GDP at market prices (% annual growth)[b]	4.9	7.1	6.8	-0.7	8.9	3.0	3.8	4.5
Current account bal/GDP (%)	-8.3	-7.7	-11.3	-6.8	-4.8	-6.7	-6.9	-7.1
Macedonia, FYR								
GDP at market prices (% annual growth)[b]	2.3	2.9	2.8	-0.4	3.1	3.0	3.5	3.7
Current account bal/GDP (%)	-6.0	-2.1	-2.5	-3.1	-1.9	-3.3	-4.1	-5.0
Montenegro								
GDP at market prices (2005 US$)[b]	..	2.5	3.2	-2.5	3.5	3.2	3.5	3.3
Current account bal/GDP (%)	-11.4	-22.9	-17.7	-18.7	-14.6	-16.9	-19.0	-20.0
Romania								
GDP at market prices (% annual growth)[b]	4.4	-0.9	2.3	0.4	3.5	2.8	3.2	2.9
Current account bal/GDP (%)	-8.0	-4.4	-4.6	-4.4	-1.1	-2.0	-1.8	-2.1
Serbia								
GDP at market prices (% annual growth)[b]	3.6	1.0	1.6	-1.5	2.5	1.0	1.5	2.5
Current account bal/GDP (%)	-9.7	-6.7	-9.1	-10.7	-5.0	-4.8	-4.6	-5.3

	00-09[a]	2010	2011	2012	2013e	2014f	2015f	2016f
Tajikistan								
GDP at market prices (% annual growth)[b]	-	-	-	7.5	7.4	6.3	6.2	5.8
Current account bal/GDP (%)	-4.8	-1.2	-4.7	-1.3	-2.7	-2.5	-2.0	-2.0
Turkey								
GDP at market prices (% annual growth)[b]	3.0	9.2	8.8	2.1	4.0	2.4	3.5	3.9
Current account bal/GDP (%)	-3.2	-6.2	-9.7	-6.1	-7.9	-6.0	-6.2	-6.8
Turkmenistan								
GDP at market prices (% annual growth)[b]	12.6	9.2	14.7	11.1	10.1	10.0	10.0	10.1
Current account bal/GDP (%)	7.4	-10.6	2.0	0.0	-3.4	-1.7	-1.5	-1.5
Ukraine								
GDP at market prices (% annual growth)[b]	3.9	4.1	5.2	0.3	0.0	-5.0	2.5	4.0
Current account bal/GDP (%)	2.0	-2.6	-6.3	-8.1	-9.2	-4.6	-4.3	-3.9
Uzbekistan								
GDP at market prices (% annual growth)[b]	6.1	8.5	8.3	8.2	8.0	7.0	6.7	6.7
Current account bal/GDP (%)	5.2	6.2	6.2	5.8	1.2	2.1	1.8	0.7

	00-09[a]	2010	2011	2012	2013e	2014f	2015f	2016f
Recently transitioned to high income countries [c]								
Croatia								
GDP at market prices (% annual growth)[b]	2.7	-2.3	-0.2	-1.9	-1.0	-0.5	1.2	1.8
Current account bal/GDP (%)	-5.6	-1.1	-0.9	-0.1	1.3	2.0	2.0	1.8
Czech Republic								
GDP at market prices (% annual growth)[b]	3.1	2.5	1.8	-1.0	-0.9	2.0	2.4	2.9
Current account bal/GDP (%)	-3.6	-3.8	-2.8	-2.4	-2.4	-1.5	-0.9	-1.8
Estonia								
GDP at market prices (% annual growth)[b]	3.2	2.6	9.6	3.9	0.8	2.0	3.0	4.0
Current account bal/GDP (%)	-9.1	2.8	1.8	-1.8	-1.0	-1.9	-2.1	-1.8
Latvia								
GDP at market prices (% annual growth)[b]	3.7	-0.3	5.3	5.0	4.1	3.8	4.0	4.6
Current account bal/GDP (%)	-10.1	3.0	-2.2	-2.5	-0.8	-1.9	-2.4	-2.4
Lithuania								
GDP at market prices (% annual growth)[b]	4.2	1.3	6.0	3.7	3.3	3.3	4.0	4.2
Current account bal/GDP (%)	-7.2	0.0	-1.4	-0.2	0.1	-0.4	-0.8	-1.2
Poland								
GDP at market prices (% annual growth)[b]	3.5	4.1	4.5	1.8	1.6	3.3	3.5	3.8
Current account bal/GDP (%)	-4.3	-5.1	-5.0	-3.7	-1.6	-2.5	-2.8	-3.2
Russian Federation								
GDP at market prices (% annual growth)[b]	4.4	4.5	4.3	3.4	1.3	0.5	1.5	2.2
Current account bal/GDP (%)	9.2	4.4	5.1	3.6	1.6	2.8	2.0	1.2
Slovak Republic								
GDP at market prices (% annual growth)[b]	4.3	4.2	3.0	1.8	0.9	2.2	3.1	3.4
Current account bal/GDP (%)	-4.6	-3.7	-2.1	2.2	2.0	1.9	2.3	2.2

Source: World Bank.
World Bank forecasts are frequently updated based on new information and changing (global) circumstances. Consequently, projections presented here may differ from those contained in other Bank documents, even if basic assessments of countries' prospects do not significantly differ at any given moment in time.
Bosnia and Herzegovina, Turkmenistan are not forecast owing to data limitations.
a. GDP growth rates over intervals are compound average; current account balance shares are simple averages over the period.
b. GDP measured in constant 2010 U.S. dollars.
c. The recently high-income countries are based on World Bank's reclassification from 2004 to 2014.